BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CUTTER LABORATORIES)

Appearances:

For Appellant: Franklin C. Latcham, Attorney at Law

For Respondent: Peter S. Pierson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Cutter Laboratories against proposed assessments of additional franchise tax in the amounts of $2,478.89, $3,208.86, $4,015.50 and $4,362.89 for the income years 1953, 1954, 1956 and 1958, respectively.

The only issue which must be considered in this appeal is whether appellant, Cutter Laboratories, was engaged in a unitary business with its wholly owned subsidiary, Haver-Lockhart Laboratories, commencing in 1956. Respondent has conceded the one issue which affected the income years 1953 and 1954, that is, whether the proposed assessments should be offset by overpayments in the amounts of $1,500 and $2,500 for the income years 1951 and 1952, respectively.

Appellant, with its head office and principal place of business in Berkeley, California, manufactures and sells throughout the United States and in certain foreign countries, vaccines, pharmaceuticals and similar products for human beings and animals. Its catalog lists 275 different products.

Appellant owns all of the stock of Haver-Lockhart Laboratories (hereafter referred to as Haver) which was

incorporated late In 1955, with its head office and principal place of business in St, Louis, Missouri. Haver, which took over the businesses of two companies which had operated for some time independently of appellant, is engaged in the manufacture and sale throughout the United States of products used by veterinarians, including operating tables, surgical instruments, pharmaceuticals and animal vaccines, Haver's catalog lists 375 products, 40 of which, mostly large-animal vaccines, are similar to products sold by appellant, Haver has no property or employees in California, Its sales are made through wholesalers located here,

Upon the formation of Haver, a number of officers and employees were permanently transferred from appellant to Haver . Three of appellant 's eight directors are members of Haver 's board of seven directors. Similarly, three of appellant's fifteen officers (a vice president and two assistant secretaries) occupy the same positions on Waver's staff of eight officers. The officers and directors who are common to both corporations reside in California, near appellant 's head. office. Haver's president, who is not on appellant 's staff of officers or directors, is responsible only to Haver's board of directors, He formulates Haver's policies and directs. and administers the company,

Among the-products manufactured by appellant' is hog cholera vaccine, substantially all of which is purchased by Haver and sold by Haver under its own label. Haver also purchases this type of vaccine from other producers at the same price it pays to appellant. From 17 to 19 percent of Haver's total purchases and from 11 to 12 percent of its sales consist of products purchased from appellant, primarily the hog cholera vaccine. These purchases represent approximately 2 percent of appellant's totalsales, Various products, constituting about 3 percent of Haver's sales and 0.7 percent of appellant 's sales, are sold by Haver to appellant,

Haver participates in general insurance coverage, an. employees' retirement plan and an automobile leasing contract, negotiated by appellant for itself and its affiliated companies. The cost of this participation, which is paid by Haver, constitutes approximately 2 percent of its overall expenses.

Haver also shares with appellant a distribution office and warehouse in Iowa. This is one of nine such offices and warehouses operated by Haves and one of thirteen operated by appellant, For its joint use, Haver pays a rental of $4,500 a year, which is approximately .15 percent of its total expenses.

The two companies do not engage in any centralized purchasing, accounting, advertising or research . Each conducts its own program in these areas.

The California Supreme Court has recently reaffirmed the tests to be used in ascertaining the existence of a unitary business. (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33]; Honolulu Oil Co. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40].) A unitary business exists when the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business *without* the state; or, from another approach, if there is unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting and management, and unity of use in its centralized executive force and general system of operation, then a business is unitary in nature.

The decisions of the Calffornfa. Supreme Court to date are marked by a broadening application of the unitary business concept. The first of these cases, Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991], involved a single corporation engaged in a merchandising business with outlets in several states. Emphasizing in particular the savings resulting from centralized purchasing of the products sold, the court held the entire business to be unitary. Subsequently, the same result was reached in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16] extending the unitary concept to embrace the operations of separately incorporated entities. In the most recent cases in this area, the Honolulu Oil and Superior Oil cases cited above, the court found that the operations were unitary despite the absence of anything equivalent to centralized purchasing of the products sold or the transfer of those products between states. The court has yet to draw a line, holding that the various portions of a business are separate rather than unitary.

Before us now are types of businesses which, though not identical in nature, are very closely related and are linked together by interlocking directorates and officers common to both corporations. The subsidiary, Haver, provides appellant with an outlet for substantially all of a particular line of products and those products represent a substantial portion of Haver's purchases and sales. In turn, appellant acquires and sells a portion of the goods produced by Haver.

Further extending the benefits available from common ownership, Haver, together with appellant and other affiliated corporations, shares in general insurance coverage, an employees' retirement plan and an automobile leasing contract. In addition, Haver *shares with* appellant a distribution office and warehouse.

In one of its most recent decisions, Superior Oil Co. v. Franchise Tax Board, supra, the California Supreme Court

repeated the following very inclusive statement from its earliest decision on the unitary business question, confirming its adoptfon of a broad view of what constitutes a unitary, business:

> It is only if its business within this state is truly separate and distinct from Its business without; this state, so that the segregation of income may be made clearly and accurately, that. the separate accounting method may properly be used, Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation Its fair share of the taxable values of the taxpayer.... If there is any evidence to sustain a finding that the operations of appellant in California during the year 1935 contributed to the net income derived from its entire operations in the United States, then the entire business of appellant is so clearly unitary as to require a fair system of apportionment by the formula method in order to prevent overtaxation to the corporation or undertaxation by the state.

Based upon the existing decisions of the California Supreme Court, we conclude that the above described features of common directors and officers, the interstate transfer of products between the corporations, the sharing of facilities:. and the joint participation in insurance, retirement and automobile leasing plans, establish the unitary nature. of. the business,, thus requiring allocation of the combined income by the formula method,

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

XT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code that the action of the Franchise Tax Board on the protest of Cutter Laboratories against proposed assessments of additional franchise tax in the amounts of $2,478.89, $3,208.86, $4,015.50 and $4,362.89 for the income years 1953, 1954, 1956 and 1958, respectively, be modified for the income years 1953 and 1954 by allowing the offset of overpayments in accordance with the concession of the Franchise Tax Board. In all other respects the action of the Franchise Tax Board Is sustained,

Done at Sacramento, California, this 17th day of November, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman

John W. Lynch, Member

_____, Member

_____, Member

_____, Member

Attest _____, Secretary